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SIPDIS

STATE FOR AF/S  
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER  
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TREASURY FOR OREN WYCHE-SHAW  
PASS USTR FLORIZELLE LISER  
STATE PASS USAID FOR MARJORIE COPSON

E. O. 12958: N/A

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SUBJECT: Devaluation of Fits and Spurts

1. Summary: The zimdollar has held steady since August 22, dropping a mere 1 percent. For a currency that has depreciated from Z\$18 to 5650:US\$1 since 1998, this may seem surprising. The zimdollar's 6-year record indicates, however, that the next steep devaluation lurks around the corner. End Summary.

#### Disappearing Value

2. The zimdollar has devalued against the U.S. dollar at the following rates over the past 6 years:

1998 -	106 percent
1999 -	11
2000 -	71
2001 -	393
2002 -	274
2003 -	397 (to date)

3. Several ominous trends have accompanied the zimdollar's tumble:

- Predictably enough, the devaluation has picked up steam as inflation has spiraled upward. During 1990-2000, inflation ranged from 47-57 percent; since 2001, it's been 112-456 percent.

- Equity prices also reflect the snowballing devaluation. Again, it's instructive to divide our sample in half. During 1998-2000, the Zimbabwe Stock Exchange's industrial average grew only 4-fold; since then, it's gone up 25-fold (but still losing most of its value in real terms).

- Consistent with mounting inflation, broad money expansion (M3) has increased steadily from an annualized 14 percent in 1998 to perhaps 350 percent today. (The Reserve Bank has yet to release M3 figures beyond March.) Expanding domestic credit has been the primary cause, even during the recent cash shortage.

- The zimdollar seems to devalue more rapidly during each year's final months, a phenomenon sometimes causing local commentators to ponder. None of the oft-cited explanations stands up to careful scrutiny, however. Given the small number of years in the sample, it may simply be that random coincidence has triggered this pattern.

#### Inconsistent Devaluation

4. A broader trend has played itself out repeatedly. The zimdollar generally firms for a number of months, then devalues in a rapid spurt. Consider these seven well-defined periods of exchange rate stability:

Period	Initial US\$ Rate	Final US\$ Rate	Change
1/98- 8/98	Z\$ 18	Z\$ 18	0%
11/98- 5/00	36	45	- 25%
6/00-12/00	59	55	+ 7%
12/01- 5/02	350	334	+ 5%
7/02-10/02	650	705	- 9%
11/02- 5/03	1500	1451	+ 3%
9/03-11/03	5600	5650	- 1%

In all, periods of exchange rate stability account for 50 of the past 70 months. During several stretches, the zimdollar actually strengthened. (Note: The second period carries a larger 25 percent devaluation. Encompassing a full 19 months, however, the devaluation barely exceeds one percent/month, which we regard as relative stability.) On the other hand, the zimdollar plummeted dramatically following each of these phases, usually by at least 100 percent over two months.

Comment

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15. Each time the zimdollar levels off, many here wonder whether the devaluation has finally run its course. At this time, such optimism is unwarranted. The GOZ has not substantially adjusted its policies. Current accounts continue to weaken, reflecting Zimbabwe's falling exports and its diminished share of the global economy. GDP is still shrinking by over 1 percent each month. For these reasons, we believe the next hefty devaluation is approaching - when and by how much, we don't know.

16. Nonetheless, the ramifications of a Z\$10,000/US\$1 exchange rate are very serious. Unless the GOZ alters its export-unfriendly policies (or finds a new benefactor), Zimbabweans will continue to lose buying power. Inflation will head toward 4-digits. Nearly all Zimbabweans will be priced out of an internationalized market for goods and services. Parastatals (e.g., railway, telecom, electricity, grain) will be unable to operate without accepting the zimdollar's market rate and raising subsidized tariffs to levels that few can afford. In its November 20 budget speech, the GOZ has an opportunity to address these issues - and inoculate itself against future depreciations - but we are not holding our breath.

Sullivan